



Increasing Local Revenue Through Percentage Leasing

Pitești, Romania

Background

Romanian cities are still under the direct control of the central government in almost all aspects of their operations and financing. In particular, cities receive nearly half of their income as direct subsidies from the government—and the amount of the subsidies is generally not finalized until nearly mid-year. Locally generated revenues derive mainly from a share of the national income tax and from leasing of non-residential properties for commercial usage. These properties cannot be sold because the central government has not yet resolved the patrimony issue. The leases are typically long term and are based on a rate per square meter, adjusted annually for inflation. Consequently, even though the business (the lessee) may prosper over the ensuing years and may benefit from the city's business development efforts, the only benefit that the city (the lessor) receives is the inflationary adjustment from the original lease.

Innovation

To increase local revenue in a fair way, percentage leasing of city controlled properties in Romania was proposed so that a city could directly benefit from its efforts to support and encourage businesses. As a city improves the area surrounding a business, encourages other businesses to locate nearby, improves transportation services, and streamlines permit and licensing procedures, the business is better able to prosper. Under a percentage lease agreement, a business shares its increased revenues with the city. The city receives regular payments from the business's operations, based on gross or net revenues as specified in the lease. The increased cash flow will enable the city to invest in further improvements to the immediate area, promoting even more prosperity for the surrounding businesses. Eventually, the revenue from percentage lease arrangements can underwrite redevelopment activities throughout the city's commercial areas.

The City of Pitești (population 180,000) has implemented a percentage lease agreement. In spring 1996 the city was approached by McDonalds Corporation about opening one or more restaurants on an appropriate site(s) to be provided by the city. The Mayor and the City Council entered into a lease arrangement with McDonalds whereby the city will provide the property and will receive 1.5% of gross sales (excluding VAT). The city has entered into a similar lease with Amoco Oil Company at a new service station site. In coming months, the city will develop standardized contracts and forms to streamline reporting procedures under percentage lease agreements.

Results

Because the new businesses have not yet begun operating, the actual revenue flow to the city cannot yet be determined. When the city does begin receiving payments from its businesses, the revenue stream will not only lessen the effects of inflation but will also reflect Pitești's efforts to improve the business climate of the community.

Perhaps the most important lesson learned by the City of Pitești from implementing percentage lease agreements is that local governments can be innovative. Historically, the absence of local autonomy and home rule prevented any action that was not specifically authorized. This innovative project has given the City of Pitești a sense of autonomy from the central government and confidence in its own decisions that along with similar actions by other Romanian cities will speed the devolution of power.

Summary

To increase local revenue in a fair way, the City of Pitești implemented percentage leasing of two city controlled properties. The resulting revenue stream will not only lessen the effects of inflation but will also reflect Pitești's efforts to improve the business climate of the community.

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